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FM AMEMBASSY JAKARTA
TO RUEHC/SECSTATE WASHDC 5229
RUEATRS/DEPT OF TREASURY WASHINGTON DC
INFO RUEHJS/ASSOCIATION OF SOUTHEAST ASIAN NATIONS
RUEHKO/AMEMBASSY TOKYO 9842
RUEHBJ/AMEMBASSY BEIJING 3455
RUEHBY/AMEMBASSY CANBERRA 9545
RUEHUL/AMEMBASSY SEOUL 3668
RUEHBR/AMEMBASSY BRASILIA 0175
RUEHBU/AMEMBASSY BUENOS AIRES 0028
RUEAIIA/CIA WASHDC

UNCLAS SECTION 01 OF 02 JAKARTA 007013

SIPDIS

SENSITIVE
SIPDIS

DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA-JEWELL
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO

E.O. 12598: N/A
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SUBJECT: INDONESIA SAYS IT WILL REPAY IMF EARLY

1. (SBU) Summary. Indonesian President Susilo Bambang Yudhoyono (SBY) announced on May 23 that Indonesia would repay the USD 7.7 billion remaining of its standby reserve loan with the International Monetary Fund (IMF) three years ahead of schedule by 2007. Bank Indonesia (BI) has reportedly proposed repaying half in 2006 and half in 2007, and is awaiting approval from the Ministry of Finance (MOF) and the Coordinating Ministry for the Economy. Indonesia's IMF loan is at favorable rates, currently about 4.9 percent, and BI earns interest on the reserves, so the country will save little from early repayment. However, the Government of Indonesia (GOI) may gain some political advantage in that early repayment may allow Finance Minister Sri Mulyani Indrawati to show her independence from the IMF (Mulyani worked as an Executive Director at the IMF before joining the Cabinet). Timing of the repayment and a clear message will be important for the GOI to gain maximum political advantage from the move. Thus far public communication has been stumbling. End summary.

2. (SBU) Indonesia has announced that it will repay the outstanding portion of its USD 7.7 billion standby reserve loan to the International Monetary Fund early, possibly in two payments, half this year, and half in 2007. While rumors of early re-payment had been circulating since February, SBY made it official when he announced the decision at a May 23 meeting of the Provincial Governments Association in Lombok, West Nusa Tenggara. Timing of the payments is still unclear but the first payment could be in the "coming few weeks", according to May 30 media reports quoting BI Governor Burhannudin Abdullah. The Jakarta IMF office told us BI sent a letter to the MOF and the Coordinating Ministry for the Economy with its early repayment proposal and is awaiting a response before formalizing a timeline.

3. (SBU) The early repayment issue first came up during a February 2006 Parliamentary hearing in which DPR members asked Mulyani for details about Indonesia's foreign debt. She reportedly provided interest rates and debt figures for the IMF loan among others and was surprised when the media interpreted her the next day as stating that Indonesia may repay the IMF early. While Coordinating Minister for the Economy Boediono and BI officials were cautious at first, the idea gained momentum in the intervening weeks.

14. (SBU) Indonesia is currently the IMF's second largest borrower after Turkey. The GOI currently has about USD 7.7 billion outstanding to the IMF, which it has been repaying at a rate of about USD 1.5 - 2 billion per year. At that rate, the GOI would have repaid the loan in full by 2010. The standby loan supports the Indonesia's foreign exchange reserves, which were at a comfortable level of USD 42.8 billion as of the end of April, up from USD 31 billion in September 2005. The standby loan has a floating interest rate updated weekly, currently about 4.9 percent, linked to three-month treasury bills in four currencies (US Dollar, British Pound, Japanese Yen, and the Euro.) While BI is not transparent about what it earns on these reserves, the IMF believes it invests in short-term debt instruments and currencies to maintain maximum liquidity. In 2005, BI earned about 3.6 percent on its reserves while paying about 3.85 percent interest to the IMF. BI currently estimates it has a slight negative spread of 0.3 percent based on 2005 numbers, but the IMF believes it is probably close to neutral now given the environment of rising interest rates.

15. (SBU) A local analyst told us BI's rule of thumb is that it tries to hold enough reserves to cover about four months of total imports (approximately USD 25 billion) and official debt repayments falling due in the current year (USD 9.3 billion), for a total of about USD 34 billion. Should BI pay back half of its standby loan in the near future, reserves would fall to approximately USD 39 billion, assuming other conditions remain unchanged. At this level,

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BI would still have as much as USD 5 billion to defend a weakening rupiah and still maintain adequate reserve coverage. Once Indonesia repays its IMF debt, the Jakarta IMF office said the formal trappings of post-program monitoring may stop, but IMF staff visits and policy dialogue would likely remain about the same.

Will the GOI Play it Right?

16. (SBU) Although few in the financial markets profess much concern about the plan to repay Indonesia's IMF debt given BI's ample reserve coverage, there are important timing and public relations factors. Some observers worry the recent bout of emerging market volatility, the May 27 earthquake in Yogyakarta, and other factors make this a bad time to repay the IMF. While the IMF has publicly welcomed the move, privately it urges caution. "The timing of repayment needs to be from a position of strength to be advantageous," the Jakarta IMF office told us. Another expatriate economist noted "the announcement needs to be loud and clear in order to gain political points. Right now the GOI just seems to be stumbling along." Some political observers have noted that President Yudhoyono would have gained more mileage out of this move had he waited another year or so and done it closer to the election campaign. A prominent Indonesian economist said, "BI needs to be clear now in its communications about what early repayment means, and how it will be advantageous. Most in the public and the media do not understand it."

Comment: Seeking Political Advantage

17. (SBU) With total anticipated savings an insignificant USD 24 million a year, political factors are driving the decision for early repayment of Indonesia's IMF debt. BI and the GOI have one eye on Brazil and Argentina's 2005 decisions to repay their IMF debt early, and hope to show the public they are independent from an organization most Indonesians view with mistrust. Mulyani has the most to

gain since she has been dogged by charges she is too friendly with the IMF given her service as an IMF Executive Director from 2002-2004. At the same time, the significant volatility in Indonesia's financial markets in the second half of May chastened the GOI and BI somewhat. By dividing repayment into two tranches, BI can maintain some control over the repayment process, and if necessary, delay or cancel the second tranche.

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